

Registered in England and Wales No: 3870728

By email only to: regfinance@ofgem.gov.uk

8 November 2024

Dear colleagues,

Ring fence review: energy networks call for input

Thank you for the opportunity to respond to the above call for input. This response is on behalf of UK Power Networks' three distribution licence holding companies: Eastern Power Networks plc, London Power Networks plc, and South Eastern Power Networks plc.

As an operator of critical national infrastructure, we take our financial performance and wider commitments to the consumer extremely seriously. As such, we welcome Ofgem's continued commitment to ensuring that network companies are financially resilient and able to fund the investments required to enable the sector to facilitate the net zero transition. This is especially pertinent considering recent failings in other regulated sectors. We agree with Ofgem's assertion that financial distress in a regulated monopoly could distract the company from focussing on providing the outputs and outcomes desired by its customers.

Nevertheless, it must be noted that, to date, there is no evidence that the failings of other sectors are being reflected in the electricity networks sector and especially not at UK Power Networks. Over the course of the RIIO-ED1 price control, UK Power Networks saw improvements in key metrics measuring network reliability, safety, and customer service satisfaction. Over the same period, we made savings against our allowed revenue of £645m, resulting in circa £340m being returned to customers through the Totex Incentive Mechanism. Therefore, while we support Ofgem's review into ring fencing, we believe the positive track record in the electricity networks sector needs to be taken into consideration as important context for the review.

UK Power Networks supports a detailed review and targeted approach to strengthening the ring fence – the third option presented in the call for input. Noting the general financial health of electricity networks, we consider it appropriate for Ofgem to take sufficient time to ensure that any measures introduced are proportionate, robust, evidence based, and the result of thorough industry engagement. We have not identified any fundamental flaws in the current electricity distribution licences that require immediate attention and believe a detailed review would be an appropriate approach as there is no "burning platform" in the sector which necessitates immediate and potentially underdeveloped remedies being introduced.

We fully support the evolution of Ofgem's approach to financial reporting, including the recent introduction of several additional reporting requirements under the Regulatory Financial Performance Report (RFPR) for the current RIIO-2 price controls as well as the proposed new obligations for energy networks in the RIIO-3 Sector Specific Methodology Decision¹ (SSMD). It

¹ See RIIO-3 SSMD for ET/GD/GT – Finance Annex published 18 July 2024, accessible here: https://www.ofgem.gov.uk/sites/default/files/2024-07/RIIO-3_SSMD_Finance_Annex.pdf



would be prudent, in our opinion, for Ofgem to allow the new information it will receive as part of these new processes to be considered as part of the review on ring fencing arrangements. This ensures that Ofgem is acting on the most up to date information possible, thereby enabling any potential additional measures introduced to fill identified gaps in the framework, ultimately ensuring the financial resilience of the sector which benefits both customers, stakeholders and shareholders.

Please see the appendix to this letter for our response to the specific questions contained within the call for input. We look forward to working with Ofgem to ensure the sector continues to deliver for customers.

Yours faithfully,



Basil Scarsella

Chief Executive Officer, UK Power Networks

Appendix

Question 1 – Have we identified the issues and challenges networks are facing accurately? (Yes / No)

Yes, we agree.

We would, however, note that Ofgem specifically mentions gas assets in this section, and we are not aware of any issues with disposals in electricity distribution. We would welcome clarity on whether Ofgem views this as a sector-wide or gas-only matter.

Question 2 – Are there any other issues that may pose a threat to the regulatory ring fence that we should consider?

We believe that Ofgem has identified the key issues.

Question 3 – Are there any weaknesses within the current ring fence conditions that we should consider?

We believe that the proposed financial resilience obligations included in the RIIO-3 SSMD, combined with the improved financial resilience reporting requirements in the RFPR, has strengthened financial resilience across the energy networks sector.

We agree with Ofgem that one area that needs to be addressed is the inclusion of a Financial Resilience Report – once certain ratings thresholds have been reached – for electricity distribution. We would welcome working with Ofgem and other industry stakeholders to develop a suitable framework for implementation into electricity distribution licensing arrangements.

Question 4 – Which would be your preferred option of the three outlined and why?

As stated in our covering letter, we support Option 3, namely a detailed review and targeted approach to strengthening the ring fence. For completeness, and to avoid duplication, please find a summary of our reasons for our position below.

UK Power Networks welcomes Ofgem's continued commitment to ensuring that network companies are financially resilient, especially in light of the recent financial failures in other regulated sectors. We agree with Ofgem that financial distress in regulated monopolies is likely to result in reduced performance for end consumers. We therefore also agree with Ofgem that a “do nothing” approach is not appropriate in this instance.

Despite this, we believe that introducing the higher intervention approach at this stage is also not appropriate. Our reasons are summarised below:

- There is no evidence that failures in other sectors are being reflected in the electricity networks sector. In fact, UK Power Networks is evidence of strong financial performance from companies within the sector.
- We have found no evidence that there are fundamental flaws in the current licences or that there is a “burning platform” which requires immediate attention.
- We therefore consider the detailed review to be the most appropriate option. This allows Ofgem to take sufficient time to ensure that any measures introduced are proportionate, robust, and the result of thorough industry engagement.

Ofgem have also recently introduced several new obligations and reporting requirements. We believe any approach should incorporate any potential learnings for these, ensuring Ofgem is acting on the most up to date information possible. In turn, this ensures that any measures introduced following the review are introduced to fill identified gaps in current arrangements.

Question 5 – What are your views on the three options and associated benefits and risks of each?

Our views on this are reflected in our answer to question 4. We believe that the immediate intervention option is unwarranted and risks introducing requirements that are not required or are disproportionate. As introducing such obligations will result in additional costs that will ultimately lead to increased customer bills, it is best practice to do so following a targeted review and continued industry engagement to ensure any additional requirements deliver real benefits to customers.

Question 6 – Tell us if you have any suggestions on how we can improve our proposed positions.

As noted previously, we are fully supportive of Ofgem conducting a detailed review of the information it receives under the RFPRs for 2023/24 and using it as an input to its proposed detailed ring fence review. We would welcome engagement with Ofgem on their RFPR review as we are eager to elicit feedback on our own reporting and to adopt best practice wherever we can.

Question 7 – Tell us about any alternate options we should consider.

No comments.